

Free Soil Community School District

REPORT ON FINANCIAL STATEMENTS
(with required supplementary information)

Year ended June 30, 2006

Free Soil Community School District

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FREE SOIL COMMUNITY SCHOOLS

Management's Discussion and Analysis

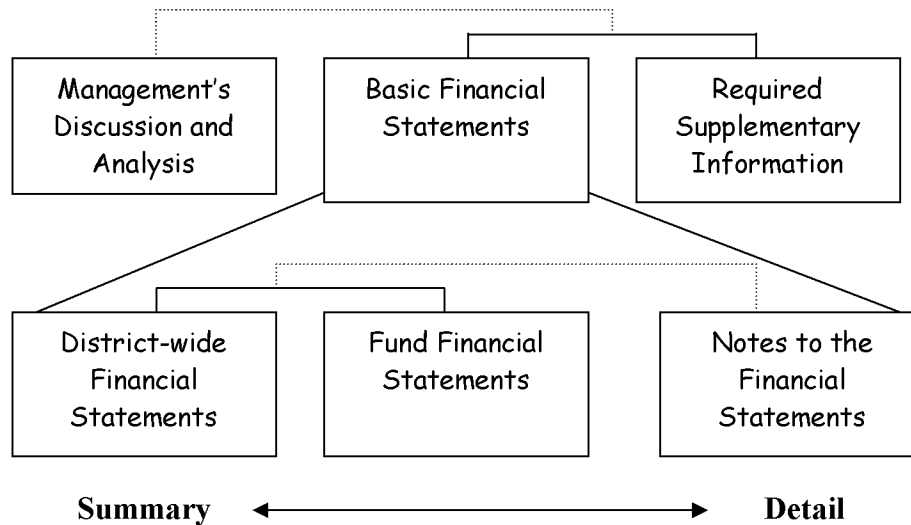
For the Fiscal Year Ended June 30, 2006

The discussion and analysis of Free Soil Community Schools' financial performance provides an overall review of the School District's financial activities for the fiscal year ended June 30, 2006. The intent of this discussion and analysis is to provide, in the layman's terms, a look at the district's performance and past and current position. Readers should also review the notes to the financial statements and financial statements to enhance their understanding of the district's financial performance.

Financial Highlights

This annual report consists of three parts: management's discussion and analysis (this section), the basic financial statements, and required supplementary information. The financial statements also include notes that explain some of the information in the statements and provide more detailed data. The statements are followed by a section of required supplementary information that further explains and supports the financial statements with a comparison of the district's budget for the year. Figure A-1 shows how the various parts of this annual report are arranged and related to one another.

Figure A-1
Free Soil Community Schools
Organization of Annual Financial Report



The basic financial statements include two kinds of statements that present different views of the district. The two kinds of statements are: 1) District-wide financial statements; and, 2) Fund financial statements.

FREE SOIL COMMUNITY SCHOOLS

Management's Discussion and Analysis

District-Wide Financial Statements

These statements are full accrual basis statements and provide information about the district's *overall* financial status. The full accrual basis means that all assets and liabilities of the District are recorded, regardless of when related cash is received or paid. They are used to help determine whether or not the District is better off or worse off as the result of the year's activities. It is important to keep in mind that while we are required to report financial information in this manner, it is not the goal of the District to generate a profit. Financial statements are just one indicator of the overall health of the District.

The *Statement of Net Assets* reports all of the district's assets and liabilities, both short-term and long-term, regardless if they are "currently available" or not. Capital assets and long-term obligations of the district are reported in this statement.

All of the current year's revenues and expenses are accounted for in the *Statement of Activities*, regardless of when cash is received or paid. The total revenue less the total expenses is referred to as the operating results for the current year. Sustained, positive operating results may indicate improving financial health, while decreasing operating results may indicate deteriorating financial health.

The two district-wide statements report the district's *net assets* and how they have changed. Net assets—the difference between the district's assets and liabilities—is one way to measure the district's financial health or position.

- Over time, increases or decreases in the district's net assets are an indicator of whether its financial position is improving or deteriorating, respectively.
- To assess the district's overall health, you need to consider additional non-financial factors such as changes in the district's property tax base, the quality of the education provided, and the condition of the District's buildings.

In the district-wide statements, the district's activities are classified as *governmental activities*. This includes most of the district's basic services, such as regular and special education, food service, athletics, transportation, and administration. Property taxes, state aid and federal grants finance most of these services.

Fund Financial Statements

The fund financial statements focus on individual parts of the district, reporting the district's operations in more detail than the district-wide statements. The fund level statements are reported on a modified accrual basis and include only the current assets and current liabilities of the District. Only those assets that are "measurable" and "currently available" are reported. Liabilities are recognized to the extent they are normally expected to be paid with current financial resources.

The fund statements are formatted to comply with the legal requirements of the Michigan Department of Education's "Accounting Manual". In the State of Michigan, the district's major instructional and instructional support activities are reported in the General Fund. Additional activities are reported in their relevant funds including: Special Revenue Funds for Food Service and Athletic activities and Fiduciary Funds.

In the fund financial statements, capital asset purchases are reported as expenditures in the year of acquisition. No asset is reported. The issuance of debt is recorded as a financial resource. The current year's payments of principal and interest on long-term obligations are recorded as expenditures. Future year's debt obligations are not recorded.

FREE SOIL COMMUNITY SCHOOLS

Management's Discussion and Analysis

Financial Analysis of the District as a Whole

The net assets of the district at June 30, 2006 amounted to \$447,447. Figure A-2 shows a condensed breakdown of the net assets.

A large portion of the district's net assets, 87%, reflects investment in capital assets (e.g., land, buildings and improvements, and equipment), less any related debt used to acquire those assets that are still outstanding. The district uses these capital assets to provide services to students; consequently, these assets are not available for future spending. Although the district's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay the debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities. The remaining net assets represent resources that are unrestricted as to how they may be used.

Figure 2-A
Condensed Statement of Net Assets

	Governmental Activities		Total Percentage Change 2005-06
	2006	2005	
Current Assets	\$ 397,914	\$ 484,897	-17.94%
Noncurrent Assets	388,467	399,871	-2.85%
Total Assets	786,381	884,768	-11.12%
Current Liabilities	326,376	401,623	-18.74%
Noncurrent Liabilities	12,558	36,981	-66.05%
Total Liabilities	338,934	438,604	-22.72%
Net Assets			
Invested in capital assets, net of related debt	388,467	371,052	4.69%
Restricted for sinking fund	48,704	-	0.00%
Unrestricted	10,276	75,112	-86.32%
Total Net Assets	\$ 447,447	\$ 446,164	0.29%

FREE SOIL COMMUNITY SCHOOLS

Management's Discussion and Analysis

The net assets of the district increased by \$1,283 during the 2005-2006 fiscal year. Figure A-3 shows the breakdown of this change. The Statement of Activities presented later in the government-wide financial statements, provides greater detail on the district's annual activity. The cost of the district's governmental activities for the year was \$1,348,728. However, the amount that the district's taxpayers ultimately financed for these activities was only \$1,118,782 because \$22,136 of the cost was paid for by those who benefited from the programs, and the other \$207,810 was paid for by other governments and organizations who subsidized certain programs with grants and contributions.

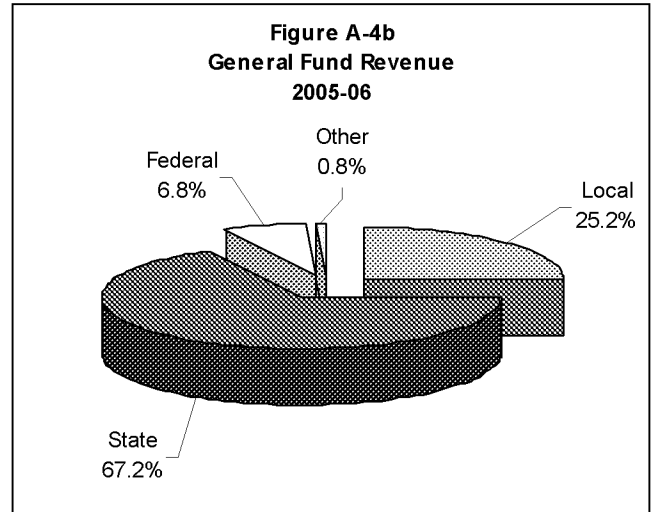
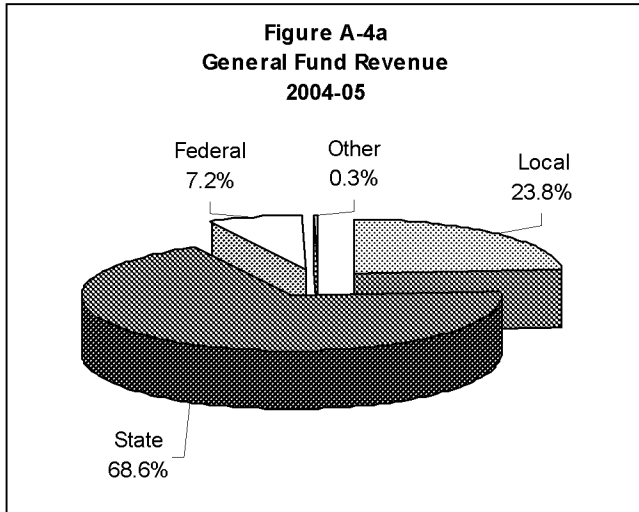
Figure A-3
Statement of Net Assets from Operating Results

	Governmental Activities		Total Percentage Change 2005-06
	2006	2005	
Revenues			
Program Revenues			
Charges for services	\$ 22,136	\$ 19,373	14.26%
Operating grants and contributions	207,810	270,428	-23.16%
General Revenues			
Property taxes - general purpose	255,214	261,377	-2.36%
Property taxes - sinking fund	78,553	-	100%
Unrestricted grants and contributions	742,522	850,164	-12.66%
Investment earnings	4,852	3,517	37.96%
Miscellaneous	22,893	66,989	-65.83%
Special Items			
Gain on sale of land	16,031	-	100.00%
Total revenues	1,350,011	1,471,848	-8.28%
Expenses			
Instruction	769,465	844,678	-8.90%
Support services	467,246	557,994	-16.26%
Food services	71,318	80,385	-11.28%
Athletics	31,508	37,167	-15.23%
Interest on long-term debt	1,541	1,305	18.08%
Unallocated depreciation	7,650	7,650	0.00%
Total expenses	1,348,728	1,529,179	-11.80%
Change in Net Assets	1,283	(57,331)	102.24%
Beginning Net Assets	446,164	503,850	-11.45%
Ending Net Assets	\$ 447,447	\$ 446,164	0.29%

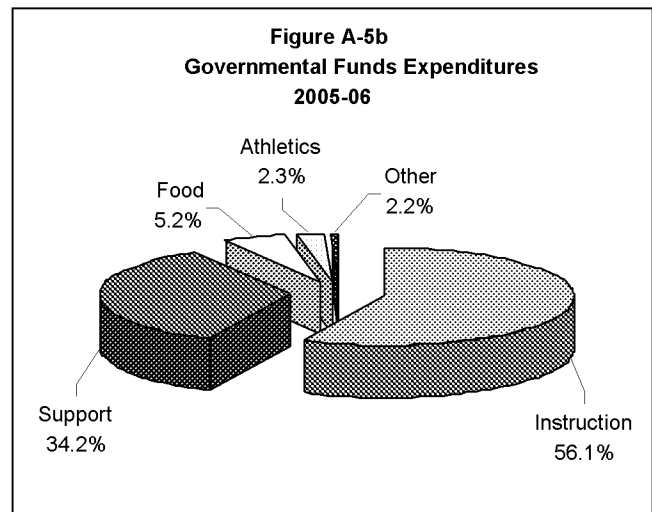
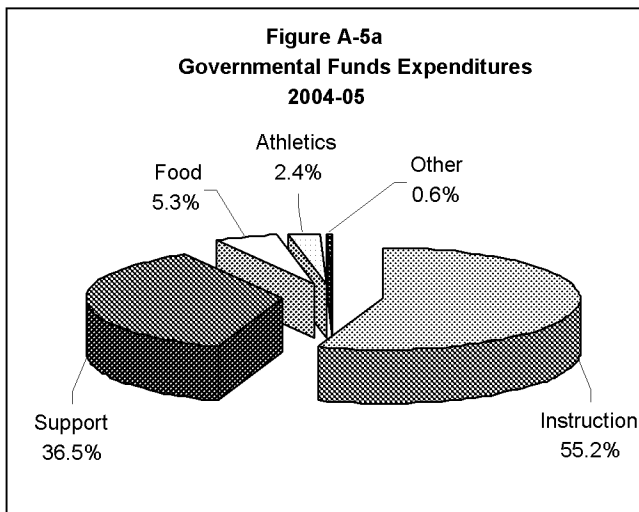
FREE SOIL COMMUNITY SCHOOLS

Management's Discussion and Analysis

A substantial portion, 68.6%, of the district's prior year revenue was received from State sources. For the year ended June 30, 2006, that percentage has declined to 67.2%. This means that the financial stability of the district rests primarily with the economic health of the State of Michigan and student enrollment. Figure A-4a depicts the breakdown of the source of revenue and other financing sources for the district's general fund during the 2004-2005 fiscal year, which totaled \$1,394,921. The breakdown for 2005-2006 fiscal year revenue, totaling \$1,214,161, is shown in Figure A-4b.



As Figure A-5a depicts, 55.2% of the district's prior year resources were spent on general fund pupil instruction. Another 36.5% was spent on support services necessary to efficiently operate the district, while the remaining 8.3% was spent on Athletics, Food Service, and Other Expenditures. Figure A-5b shows the breakdown of how the district spent the current year resources. The general fund pupil instruction increased to 57.0%. Support services costs decreased by 1.8% and Athletics, Food Service, and Other Expenditures remained at 8.3%.



FREE SOIL COMMUNITY SCHOOLS

Management's Discussion and Analysis

Financial Analysis of the District's Funds

The financial performance of the district as a whole is reflected in its governmental funds as well. The combined governmental funds equity increased by \$3,078 during the 2005-06 fiscal year, resulting in fund equity of \$71,538 at the year end. The primary reasons for the increase in fund balance are:

- State aid funding was reduced by 14.3% due to a decline in the district's K-12 student enrollment.
- Support service, administrative, and instructional expenditures decreased due to the following:
 - ◆ Replaced business manager with a bookkeeper at a lesser salary,
 - ◆ New superintendent at a lesser salary than his predecessor, and
 - ◆ Elementary teacher moved from instruction to administrative staff.
- The electorate approved a sinking fund levy which generated \$78,553 in property tax revenue.

General Fund Budgetary Highlights

The Uniform Budget Act of the State of Michigan requires that the local Board of Education approve the original budget for the upcoming fiscal year prior to July 1, the start of the fiscal year. As a matter of practice, the district amends its budget during the school year. These revisions are made in order to deal with unexpected changes in revenues and expenditures. The following analysis describes the significant General Fund final budget to actual variances and the reasons for changes in the budget during the year. Amounts are expressed to the nearest thousand.

Figure A-6
General Fund Budget vs. Actual Comparison

	Original Budget	Final Budget	Actual	Variance- Pos (Neg)
REVENUES				
Local sources	\$ 253.2	\$ 291.8	\$ 305.4	\$ 13.6
State sources	830.5	808.6	816.4	7.8
Federal sources	65.1	81.4	82.3	0.9
Incoming transfers	17.5	122.7	10.0	(112.7)
Total revenues	1,166.3	1,304.5	1,214.1	(90.4)
EXPENDITURES				
Instruction				
Basic programs	669.8	632.6	588.9	(43.7)
Added needs	184.8	179.0	177.8	(1.2)
Support Services				
Pupil	22.0	19.6	20.1	0.5
General administration	152.5	186.7	181.1	(5.6)
Business	63.4	39.2	36.7	(2.5)
Operations and maintenance	157.8	171.5	119.2	(52.3)
Pupil transportation services	94.2	87.3	91.0	3.7
Central	5.2	19.6	19.0	(0.6)
Outgoing transfers and fund modifications	50.0	27.6	23.4	(4.2)
Total expenditures	1,399.7	1,363.1	1,257.2	(105.9)
Excess (deficiency) of revenues over (under) expenditures	\$ (233.4)	\$ (58.6)	\$ (43.1)	\$ 15.5

FREE SOIL COMMUNITY SCHOOLS

Management's Discussion and Analysis

Budget to Actual variances—There were three material budget vs. actual variances.

- The incoming transfers section of the budget included reimbursed expenditures and an insurance claim classified as revenue. The accounting netted these reimbursements against their respective expenditures.
- The basic programs section the budget did not include applying reimbursement to the expenditures. The accounting removed this reimbursement from revenues and netted them against their respective expenditures.
- The operations and maintenance section of the budget included fixing gymnasium floor. The accounting netted the insurance proceeds against the expenditure.

Revenues—Significant changes in revenue budgets were as follows:

- The local source revenue budget was increased due to fundraising activities and property tax increases.
- The state source revenue budget was originally budgeted at \$830.5 but was reduced to \$808.6 due to reduction in pupil count.
- The federal source revenue budget was increased for amounts deferred in 04/05 due to 60-day collection rule that were recognized as revenue in the current year.
- The incoming transfers revenue budget was increased for the insurance proceeds and reimbursed expenditures, but those amounts were subsequently netted against expenditures.

Expenditures—Significant changes in expenditure budgets were as follows:

- Basic programs budget was reduced for teacher cuts needed to balance budget.
- General administration budget was increased for the actual contract amount with the new superintendent that was greater than originally budgeted.
- Business budget was reduced by replacing a business manager with a bookkeeper.
- Outgoing transfers budget was reduced for anticipated transfers to food service and athletics.

Capital Assets and Debt Administration

Capital Assets—a comparative summary of the district's capital assets (net of depreciation at year end) is identified below:

	<u>2006</u>	<u>2005</u>
Land	\$ 55,100	\$ 56,700
Buildings and improvements	<u>333,367</u>	<u>343,171</u>
Total	<u>\$ 388,467</u>	<u>\$ 399,871</u>

The school district sold an eight acre parcel of land in 05/06.

Debt Administration—a comparative summary of the district's indebtedness is outlined below:

	<u>2006</u>	<u>2005</u>
Note Payable—Land	-	28,819
Compensated Absences	<u>12,558</u>	<u>12,512</u>
Total	<u>\$ 12,558</u>	<u>\$ 41,331</u>

The school district paid off the note payable—land with sinking fund proceeds in 05/06.

FREE SOIL COMMUNITY SCHOOLS

Management's Discussion and Analysis

Currently Known Facts, Decisions, and Conditions Affecting the June 30, 2007 Fiscal Year:

The economic climate in Michigan has not been positive. Because education funding is largely based on business taxes, a slumping economy has a direct and negative impact on education funding. In the past four years, Michigan school districts have received only one increase in state funding levels. In the 2006-2007 fiscal year, additional state funding has been secured. However, it appears that inflationary cost increases in employee health insurance and retirement benefits will likely exceed the increase in funding. Rising energy and fuel costs will also strain operating budgets. As businesses have left the area to seek more favorable economic conditions, they have taken families with them. The population decline has resulted in Mason and Manistee County school districts competing with each other for students.

Free Soil Community School's has taken the following actions to reduce costs for the 06/07 year:

- Teaching staff has been reduced from 13 teachers in 05/06 to 8 teachers in 06/07.
- The food service program has been outsourced to another public school which brings meals in for the Free Soil students.
- The Superintendent's position has been reduced from a full-time position to a half-time position.

The Free Soil Education Association collective bargaining agreement expired June 30, 2005. Negotiations are in progress as of the date of this audit. A 3-year, 2.5 mill, Sinking Fund Millage proposal for capital improvements was successfully passed by voters in the November 8, 2005 millage election. The tax is estimated to raise approximately \$72,000 annually.

Requests for Information

This financial report is designed to provide our citizens, taxpayers, parents, students, and investors and creditors with a general overview of the district's finances and to show the district's accountability for the money it receives. Questions concerning any of the information provided in this report, or requests for additional financial information should be addressed to the Superintendent of Schools, Free Soil Community Schools, 8480 N. Democrat Street, Free Soil, Michigan 49411, telephone number 231/464-5651.

BRICKLEY DELONG

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

November 1, 2006

Board of Education
Free Soil Community School District
Free Soil, Michigan

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Free Soil Community School District (the School District), as of and for the year ended June 30, 2006, which collectively comprise the School District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Free Soil Community School District's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of Free Soil Community School District, as of June 30, 2006, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 1, 2006, on our consideration of Free Soil Community School District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis and budgetary comparison information on pages i - viii and page 22, are not a required part of the basic financial statement but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Free Soil Community School District
STATEMENT OF NET ASSETS
June 30, 2006

	Governmental activities
ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	\$ 242,607
Receivables	49
Due from other governmental units	145,258
Prepaid items	<u>10,000</u>
Total current assets	397,914
NONCURRENT ASSETS	
Capital assets, net	
Nondepreciable	55,100
Depreciable	<u>333,367</u>
Total noncurrent assets	<u>388,467</u>
Total assets	786,381
LIABILITIES AND NET ASSETS	
CURRENT LIABILITIES	
State aid loan	160,000
Accounts payable and accrued liabilities	136,676
Due to other governmental units	<u>29,700</u>
Total current liabilities	326,376
NONCURRENT LIABILITIES	
Compensated absences	<u>12,558</u>
Total liabilities	<u>338,934</u>
NET ASSETS	
Invested in capital assets, net of related debt	388,467
Restricted for sinking fund	48,704
Unrestricted	<u>10,276</u>
Total net assets	<u>\$ 447,447</u>

The accompanying notes are an integral part of this statement.

Free Soil Community School District
STATEMENT OF ACTIVITIES
For the year ended June 30, 2006

<i>Functions/Programs</i>	<u>Expenses</u>	<u>Program Revenue</u>		Net (Expense)
		<u>Charges for services</u>	<u>Operating grants and contributions</u>	Revenue and Changes in Net Assets
Governmental activities				<u>Governmental activities</u>
Instruction	\$ 769,465	\$ 802	\$ 144,704	\$ (623,959)
Support services	467,246	-	6,902	(460,344)
Food services	71,318	11,781	50,297	(9,240)
Athletics	31,508	9,553	5,907	(16,048)
Interest on long-term debt	1,541	-	-	(1,541)
Unallocated depreciation	7,650	-	-	(7,650)
Total governmental activities	<u>\$ 1,348,728</u>	<u>\$ 22,136</u>	<u>\$ 207,810</u>	<u>(1,118,782)</u>
General revenues				
Property taxes levied for				
General purposes				255,214
Sinking fund				78,553
Grants and contributions not restricted to specific programs				742,522
Investment earnings				4,852
Miscellaneous				22,893
Special item—gain on sale of land				16,031
Total general revenues and special items				<u>1,120,065</u>
Change in net assets				1,283
Net assets at July 1, 2005				<u>446,164</u>
Net assets at June 30, 2006				<u>\$ 447,447</u>

The accompanying notes are an integral part of this statement.

Free Soil Community School District

BALANCE SHEET

Governmental Funds

June 30, 2006

	General Fund	Sinking Fund	Other governmental funds	Total governmental funds
ASSETS				
Cash and cash equivalents	\$ 200,465	\$ 41,613	\$ 529	\$ 242,607
Receivables	-	-	49	49
Due from other governmental units	145,258	-	-	145,258
Due from other funds	229	7,091	639	7,959
Prepaid items	10,000	-	-	10,000
Total assets	<u>\$ 355,952</u>	<u>\$ 48,704</u>	<u>\$ 1,217</u>	<u>\$ 405,873</u>
LIABILITIES AND FUND BALANCES				
Liabilities				
State aid loan	\$ 160,000	\$ -	\$ -	\$ 160,000
Accounts payable	2,222	-	268	2,490
Accrued liabilities	133,466	-	720	134,186
Due to other governmental units	29,700	-	-	29,700
Due to other funds	7,730	-	229	7,959
Total liabilities	333,118	-	1,217	334,335
Fund balances				
Reserved for prepaid items	10,000	-	-	10,000
Unreserved				
Undesignated				
General Fund	12,834	-	-	12,834
Sinking Fund	-	48,704	-	48,704
School service	-	-	-	-
Total fund balances	<u>22,834</u>	<u>48,704</u>	<u>-</u>	<u>71,538</u>
Total liabilities and fund balances	<u>\$ 355,952</u>	<u>\$ 48,704</u>	<u>\$ 1,217</u>	<u>\$ 405,873</u>

The accompanying notes are an integral part of this statement.

Free Soil Community School District
**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
TO THE STATEMENT OF NET ASSETS**
June 30, 2006

Total fund balance—governmental funds	\$	71,538
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Amounts reported for governmental activities in the Statement of Net Assets
are different because:

Capital assets used in governmental activities are not current financial
resources and are not reported in the governmental funds.

Cost of capital assets	\$	719,715	
Accumulated depreciation		<u>(331,248)</u>	388,467

Long-term liabilities in governmental activities are not due and payable in the
current period and are not reported in the governmental funds.

Compensated absences	<u>(12,558)</u>
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Net assets of governmental activities in the Statement of Net Assets	\$	<u><u>447,447</u></u>
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The accompanying notes are an integral part of this statement.

Free Soil Community School District
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
Governmental Funds
For the year ended June 30, 2006

	General Fund	Sinking Fund	Other governmental funds	Total governmental funds
REVENUES				
Local sources				
Property taxes	\$ 255,214	\$ 78,553	\$ -	\$ 333,767
Investment earnings	4,329	523	-	4,852
Fees and charges	-	-	21,334	21,334
Fundraising and contributions	17,486	-	5,907	23,393
Other	28,397	-	-	28,397
Total local sources	305,426	79,076	27,241	411,743
State sources	816,398	-	7,305	823,703
Federal sources	82,337	-	42,992	125,329
Total revenues	1,204,161	79,076	77,538	1,360,775
EXPENDITURES				
Instruction	766,656	-	-	766,656
Support services	467,234	-	-	467,234
Food services	-	-	71,318	71,318
Athletics	-	-	31,508	31,508
Debt service				
Principal	-	28,824	-	28,824
Interest and other charges	-	1,548	-	1,548
Total expenditures	1,233,890	30,372	102,826	1,367,088
Excess (deficiency) of revenues over (under) expenditures	(29,729)	48,704	(25,288)	(6,313)
OTHER FINANCING SOURCES (USES)				
Transfers from other governmental units and other transactions	10,000	-	-	10,000
Transfers in	-	-	22,764	22,764
Transfers out	(22,764)	-	-	(22,764)
Transfers to other governmental units and other transactions	(609)	-	-	(609)
Total other financing sources (uses)	(13,373)	-	22,764	9,391
Net change in fund balances	(43,102)	48,704	(2,524)	3,078
Fund balances at July 1, 2005	65,936	-	2,524	68,460
Fund balances at June 30, 2006	\$ 22,834	\$ 48,704	\$ -	\$ 71,538

The accompanying notes are an integral part of this statement.

Free Soil Community School District
**RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES TO THE STATEMENT OF ACTIVITIES**
For the year ended June 30, 2006

Net change in fund balances—total governmental funds	\$ 3,078
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Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental funds report outlays for capital assets as expenditures; in the Statement of Activities these costs are depreciated over their estimated useful lives.

Depreciation expense	(9,804)
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Governmental funds report the entire proceeds from the sale of capital assets as revenue, but the Statement of Activities reports only the gain or loss on the sale of capital assets.

(1,600)

Revenue reported in the Statement of Activities that does not provide current financial resources are not reported as revenue in the governmental funds.

(19,164)

Repayment of principal on long-term debt is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets.

28,819

Compensated absences are reported on the accrual method in the Statement of Activities and reported as expenditures when financial resources are used in the governmental funds.

(46)

Change in net assets of governmental activities

\$ 1,283

The accompanying notes are an integral part of this statement.

Free Soil Community School District
STATEMENT OF FIDUCIARY ASSETS AND LIABILITIES
Fiduciary Funds
June 30, 2006

	Agency funds
	<u> </u>
ASSETS	
Cash and cash equivalents	\$ 8,158
	<u> </u>
LIABILITIES	
Deposits held for others	\$ 8,158
	<u> </u>

The accompanying notes are an integral part of this statement.

Free Soil Community School District
NOTES TO FINANCIAL STATEMENTS
June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of Free Soil Community School District (School District) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the School District's accounting policies are described below.

Reporting Entity

The School District is governed by an elected seven-member Board of Education (Board), which has responsibility and control over all activities related to public school education within the School District. The School District receives funding from local, state, and federal government sources and must comply with all of the requirements of these funding source entities. However, the School District is not included in any other governmental reporting entity as defined by generally accepted accounting principles. In addition, the School District's reporting entity does not contain any component units as defined in Governmental Accounting Standards Board Statement No. 14. Board members have decision-making authority, the power to designate management, the ability to significantly influence operations, and the primary accountability for fiscal matters.

District-wide and Fund Financial Statements

District-wide Financial Statements – The primary focus of district-wide financial statements is on the sustainability of the School District as an entity and the change in the School District's net assets resulting from the current year's activities. The district-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the non-fiduciary activities of the School District. For the most part, the effect of interfund activity has been removed from these statements. The district-wide financial statements categorize primary activities as either governmental or business type. All of the School District's activities are classified as governmental activities.

In the district-wide statement of net assets, the governmental activities column (a) is presented on a consolidated basis and (b) is reported on a full accrual, economic resource basis, which recognizes all long-term assets and receivables as well as long-term debt and obligations. The School District's net assets are reported in three parts – invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. The School District first utilizes restricted resources to finance qualifying activities. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges paid by recipients who purchase, use or directly benefit from goods or services by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. State Foundation Aid, certain revenue from the intermediate school district, and other unrestricted items are not included as program revenues but instead as *general revenues*.

The district-wide statement of activities reports both the gross and net cost of each of the School District's functions. The functions are also supported by general revenues (property taxes, certain intergovernmental revenues and charges, etc.). The statement of activities reduces gross expenses by related program revenues and operating grants. Program revenues must be directly associated with the function. Operating grants include operating-specific and discretionary (either operating or capital) grants. The School District does not allocate indirect costs.

Free Soil Community School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

District-wide and Fund Financial Statements—Continued

Fund financial statements – Fund financial statements are provided for governmental funds and fiduciary funds, even though the latter are excluded from district-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements.

Governmental funds – Governmental funds are those funds through which most School District functions typically are financed. The acquisition, use and balances of the School District's expendable financial resources and the related current liabilities are accounted for through governmental funds.

The School District reports the following major governmental funds:

- The *General Fund* is the School District's primary operating fund. It accounts for all financial resources of the School District, except those required to be accounted for in another fund.
- The *Sinking Fund* accounts for the sinking fund property taxes received for the acquisition of real estate, construction of school buildings or the repair of school buildings.

The other nonmajor governmental funds are reported within the following types:

- The *special revenue funds* account for revenue sources that are legally restricted to expenditures for specific purposes (not including expendable trusts or major capital projects). The School District accounts for its food service and athletic activities in the school service special revenue funds.

Fiduciary funds – Fiduciary funds account for assets held by the School District in a trustee capacity or as an agent on behalf of others. Fiduciary funds are not included in the district-wide statements.

- The *agency fund* is custodial in nature and does not present results of operations or have a measurement focus. Agency funds are accounted for using the modified accrual basis of accounting. This fund is used to account for assets that the School District holds for others in an agency capacity (primarily student activities).

Measurement Focus, Basis of Accounting and Basis of Presentation

Accrual Method

The district-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants, categorical aids and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Modified Accrual Method

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. With this measurement focus, operating statements present increases and decreases in net current assets, and unreserved fund balance is a measure of available spendable resources. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the School District considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as compensated absences and claims and judgments, are recorded only when payment is due.

Free Soil Community School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Measurement Focus, Basis of Accounting and Basis of Presentation—Continued

Modified Accrual Method—Continued

Property taxes, unrestricted state aid, intergovernmental grants, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the School District.

State Revenue

The State of Michigan utilizes a foundation grant approach which provides for a specific annual amount of revenue per pupil based on a statewide formula. The Foundation is funded from state and local sources. Revenues from state sources are primarily governed by the School Aid Act and the School Code of Michigan. The Michigan Department of Education administers the allocation of state funds to school districts based on information supplied by the school districts. For the year ended June 30, 2006, the foundation allowance was based on pupil membership counts taken in February and September of 2005.

The state portion of the foundation is provided primarily by a state education property tax millage of 6 mills and an allocated portion of state sales and other taxes. The local portion of the foundation is funded primarily by non-homestead property taxes which may be levied at a rate of up to 18 mills. The state revenue is recognized during the foundation period and is funded through payments from October 2005 to August 2006. Thus, the unpaid portion at June 30, 2006 is reported as due from other governmental units.

The School District also receives revenue from the state to administer certain categorical education programs. State rules require that revenue earmarked for these programs be used for its specific purpose. Certain governmental funds require an accounting to the state of the expenditures incurred. For categorical funds meeting this requirement, funds received, which are not expended by the close of the fiscal year are recorded as deferred revenue. Other categorical funding is recognized when the appropriation is received.

Other Accounting Policies

Deposit and Investments

Cash and cash equivalents include cash on hand, demand deposits and short-term investments with a maturity of three months or less when acquired. Investments are stated at fair value.

The School District reports its investments in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Under this standard, certain investments are valued at fair value as determined by quoted market prices or by estimated fair values when quoted market prices are not available. The standard also provides that certain investments are valued at cost (or amortized cost) when they are of a short-term duration, the rate of return is fixed, and the School District intends to hold the investment until maturity.

State statutes authorize the School District to invest in bonds and other direct and certain indirect obligations of the U.S. Treasury; certificates of deposit, savings accounts, deposit accounts, or depository receipts of a bank, savings and loan association, or credit union, which is a member of the Federal Deposit Insurance Corporation, Federal Savings and Loan Insurance Corporation, or National Credit Union Administration, respectively; in commercial paper rated at the time of purchase within the three highest classifications established by not less than two standard rating services and which matures not more than 270 days after the date of purchase. The School District is also authorized to invest in U. S. Government or federal agency obligation repurchase agreements, bankers' acceptances of U.S. banks, and mutual funds composed of investments as outlined above. The School District's deposits and investments are in accordance with statutory authority.

Free Soil Community School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Other Accounting Policies—Continued

Interfund Receivables and Payables

Activities between funds that are representative of lending or borrowing arrangements outstanding at the end of the fiscal year are referred to as either “due to/from other funds” (i.e., the current portion of interfund loans) or “advances to/from other funds” (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as “due to/from other funds”. The School District had no advances between funds.

Property Taxes

Property taxes levied by the School District are collected by various municipalities and periodically remitted to the School District. The taxes are levied as of December 1 and are due upon receipt of the billing by the taxpayer and become a lien on the first day of the levy year. The actual due date is February 14, after which time the bills become delinquent and penalties and interest may be assessed by the collecting entity.

For the year ended June 30, 2006, the School District levied the following amounts per \$1,000 of assessed valuation:

<u>Fund</u>	<u>Mills</u>
General Fund - Non-homestead	16.3305
Sinking Fund - Homestead and non-homestead	2.5

Prepaid Items

Payments made to vendors for services that will benefit periods beyond the fiscal year end are recorded as prepaid items using the consumption method. A current asset for the prepaid amount is recorded at the time of the purchase and an expenditure/expense is reported in the year in which services are consumed.

Restricted Assets

Assets are reported as restricted when limitations on their use change the normal understanding of the availability of the asset. Such constraints are either imposed by creditors, contributors, grantors, or laws of other governments or imposed by enabling legislation. Restricted assets include bond proceeds to be used for capital construction.

Capital Assets

Capital assets purchased or acquired are capitalized at historical cost or estimated historical cost. Donated fixed assets are valued at their estimated fair market value on the date received. Capital assets are defined by the School District as assets with an initial cost of more than \$5,000 and an estimated useful life in excess of one year. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Improvements are capitalized and depreciated over the remaining useful lives of the related fixed assets. The School District does not have infrastructure-type assets.

Depreciation is provided on the straight-line basis over the following useful lives:

Buildings and improvements	25-50 years
Buses and other vehicles	10 years
Furniture and other equipment	5-20 years

Land and certain land improvements are deemed to be inexhaustible capital assets, as the economic benefit or service potential is used up so slowly that the estimated useful life is extraordinarily long. These inexhaustible assets are not depreciated.

Free Soil Community School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Other Accounting Policies—Continued

Compensated Absences

The liability for compensated absences reported in the district-wide statement consists of unpaid, accumulated sick leave balances. The liability has been calculated using the vesting method, in which leave amounts for both employees who are currently eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included.

For fund financial statements, no compensated absence liability is reported for current employees and a compensated absence liability is reported for terminated employees only when the termination date is on or before year end.

Deferred Revenue

Deferred revenue arises when assets are recorded before revenue recognition criteria have been satisfied. Grants and entitlements received before the eligibility requirements are met are also recorded as deferred revenue. On fund financial statements, receivables that will be collected after the available period are reported as deferred revenue.

Long-term Obligations

In the district-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the Statement of Net Assets. Bond premiums and discounts, as well as issuance cost, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Net Assets In District-wide Financial Statements

Net assets represent the difference between assets and liabilities and are segregated into the following components:

- **Invested in capital assets, net of related debt** consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- **Restricted net assets** result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributions, and the like, or imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted net assets** consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources which are imposed by management, but can be removed or modified.

Free Soil Community School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Other Accounting Policies—Continued

Fund Equity In Fund Financial Statements

The School District reserves those portions of governmental fund balances that are legally segregated for specific future use or which do not represent available expendable resources and therefore are not available for appropriations for expenditures. Unreserved fund balance indicates that portion of fund equity which is available for appropriation in future periods. Fund balance reserves are established for encumbrances, inventory of materials and supplies, prepaid items, deferred charges and advances to other funds, when applicable. Designations of fund balance represent tentative management plans that are subject to change.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statement and accompanying notes. Actual results may differ from those estimates.

NOTE B—STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Budgets and Budgetary Accounting

Budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America. Annual appropriated budgets are adopted for the General Fund and special revenue funds. All annual appropriations lapse at year end.

The School District follows these procedures in establishing the budgetary data reflected in the financial statements:

1. The Superintendent submits to the School Board a proposed operating budget for the fiscal year commencing on July 1. The operating budget includes proposed expenditures and the means of financing them. The level of control for the budgets is at the functional level as set forth and presented as required supplementary information.
2. Public hearings are conducted to obtain taxpayer comments.
3. Prior to July 1, the budget is legally adopted by Board of Education resolution pursuant to the Uniform Budgeting and Accounting Act (P.A. 621 of 1978). The Act requires that the budget be amended prior to the end of the fiscal year when necessary to adjust appropriations if it appears that revenues and other financing sources will be less than anticipated or so that expenditures will not be in excess of original estimates. Expenditures shall not be made or incurred, unless authorized in the budget, in excess of the amount appropriated. Violations, if any, are noted in the required supplementary information section.
4. The Superintendent is authorized to transfer budgeted amounts within major expenditure functions within any fund; however, these transfers and any revisions that alter the total expenditures of any fund must be approved by the Board of Education.
5. Formal budgetary integration is employed as a management control device during the year.
6. The budget is amended during the year with supplemental appropriations, the last one approved prior to June 30, 2006. The School District does not consider these amendments to be significant.

Free Soil Community School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE B—STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY—Continued

Excess of Expenditures Over Appropriations

The School District did not have significant expenditure budget variances.

Sinking Fund

The Sinking Fund Capital Project Fund records capital project activities funded with Sinking Fund millage. For this fund the School District has complied with the applicable provisions of §1212(1) of the Revised School Code and the applicable section of the Revised Bulletin for School District Audits of Bonded Construction Funds and of Sinking Funds in Michigan.

NOTE C—DEPOSITS AND INVESTMENTS

As of June 30, 2006, the School District had no investments.

Interest rate risk. In accordance with its investment policy, the School District will minimize interest rate risk, which is the risk that the market value of securities in the portfolio will fall due to changes in interest rates by; structuring the investment portfolio so that securities mature to meet cash requirements for ongoing operations, thereby avoiding the need to sell securities in the open market; and, investing operating funds primarily in shorter-term securities, liquid asset funds, money market mutual funds, or similar investment pools and limiting the average maturity in accordance with the School District's cash requirements.

Credit risk. State law limits investments in commercial paper and corporate bonds to the three highest classifications issued by nationally recognized statistical rating organizations. The School District has no investment policy that would further limit its investment choices.

Concentration of credit risk. In accordance with its investment policy, the School District will minimize concentration of credit risk, which is the risk of loss attributed to the magnitude of the School District investment in a single issuer, by diversifying the investment portfolio so that the impact of potential losses from any one type of security or issuer will be minimized.

Custodial credit risk - deposits. In the case of deposits, this is the risk that in the event of a bank failure, the School District's deposits may not be returned to it. As of June 30, 2006, \$160,756 of the School District's bank balance of \$260,756 was exposed to custodial credit risk because it was uninsured and uncollateralized.

Custodial credit risk - investments. For an investment this is the risk that, in the event of the failure of the counterparty, the School District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party.

The School District will minimize custodial credit risk, which is the risk of loss due to the failure of the security issuer or backer, by; limiting investments to the types of securities allowed by law; and pre-qualifying the financial institutions, broker/dealers, intermediaries and advisors with which the School District will do business.

Foreign currency risk. The School District is not authorized to invest in investments which have this type of risk.

Free Soil Community School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE D—CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2006 was as follows:

	Balance July 1, 2005	Additions	Deductions	Balance June 30, 2006
Capital assets, not being depreciated:				
Land	\$ 56,700	\$ -	\$ 1,600	\$ 55,100
Total capital assets, not being depreciated	56,700	-	1,600	55,100
Capital assets, being depreciated:				
Buildings and improvements	634,620	-	-	634,620
Vehicles	105,413	-	75,418	29,995
Total capital assets, being depreciated	740,033	-	75,418	664,615
Less accumulated depreciation:				
Buildings and improvements	291,449	9,804	-	301,253
Vehicles	105,413	-	75,418	29,995
Total accumulated depreciation	396,862	9,804	75,418	331,248
Total capital assets, being depreciated, net	343,171	(9,804)	-	333,367
Capital assets, net	<u>\$ 399,871</u>	<u>\$ (9,804)</u>	<u>\$ 1,600</u>	<u>\$ 388,467</u>

Depreciation

Depreciation expense has been charged to functions as follows:

Instruction	\$ 2,154
Unallocated depreciation	<u>7,650</u>
	<u>\$ 9,804</u>

Free Soil Community School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE E—INTERFUND RECEIVABLES, PAYABLES AND TRANSFERS

Interfund Obligations

The composition of interfund balances as of June 30 2006 is as follows:

Due to/from other funds:

<u>Receivable fund</u>	<u>Payable fund</u>	<u>Amount</u>
General Fund	Other governmental funds	\$ 229
Sinking Fund	General Fund	7,091
Other governmental funds	General Fund	639
		<u>\$ 7,959</u>

The outstanding balances between funds result mainly from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made.

Interfund Transfers

The General Fund transferred \$6,716 to the Food Services Fund and \$16,048 to the Athletics Fund to finance operations.

NOTE F—SHORT-TERM DEBT

The School District issues State of Michigan school aid anticipation notes to provide short-term operating funds. The notes are obligations of the General Fund, which received the note proceeds, and are backed by the full faith, credit and resources of the School District. The short-term debt activity for the year ended June 30, 2006 follows:

	<u>Balance</u> <u>July 1, 2005</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30, 2006</u>
State aid anticipation note				
2004/2005 1.57% due August 2005	\$ 180,000	\$ -	\$ 180,000	\$ -
2005/2006 3.15% due August 2006	<u>-</u>	<u>160,000</u>	<u>-</u>	<u>160,000</u>
	<u>\$ 180,000</u>	<u>\$ 160,000</u>	<u>\$ 180,000</u>	<u>\$ 160,000</u>

Free Soil Community School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE G—LONG-TERM OBLIGATIONS

The School District issues bonds, notes and other contractual commitments to provide for the acquisition, construction and improvement of major capital facilities and for the acquisition of certain equipment. All long-term obligations are being paid by the General Fund.

Summary of Long-term Obligations

The following is a summary of long-term obligations activity for the School District for the year ended June 30, 2006:

	<u>Balance</u> <u>July 1, 2005</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30, 2006</u>	<u>Due within</u> <u>one year</u>
Governmental activities:					
Installment purchase agreement	\$ 28,819	\$ -	\$ 28,819	\$ -	\$ -
Compensated absences	12,512	3,900	3,854	12,558	-
	<u>\$ 41,331</u>	<u>\$ 3,900</u>	<u>\$ 32,673</u>	<u>\$ 12,558</u>	<u>\$ -</u>

The installment purchase agreement was paid off by the Sinking Fund.

NOTE H—EMPLOYEE BENEFITS

Employee Retirement System – Defined Benefit Plan

Plan description – The School District contributes to the statewide Michigan Public School Employees' Retirement System (MPSERS), a cost sharing multiple-employer defined benefit pension plan administered by the nine member board of the MPSERS. The MPSERS provides retirement benefits and post-retirement benefits for health, dental and vision. The MPSERS was established by Public Act 136 of 1945 and operated under the provisions of Public Act 300 of 1980, as amended. The MPSERS issues a publicly available financial report that includes financial statements and required supplementary information for MPSERS. That report may be obtained by writing to or calling:

Office of Retirement Systems
Michigan Public School Employees Retirement System
P.O. Box 30171
Lansing Michigan 48909
1-800-381-5111

Funding policy – Member Investment Plan (MIP) members enrolled in MIP prior to January 1, 1990 contribute a permanently fixed rate of 3.9 percent of gross wages. The MIP contribution rate was 4.0 percent from January 1, 1987, the effective date of the MIP, until January 1, 1990 when it was reduced to 3.9 percent. Members first hired January 1, 1990 or later and returning members who did not work between January 1, 1987 through December 31, 1989 contribute at the following graduated permanently fixed contribution rate: 3 percent of the first \$5,000; 3.6 percent of \$5,001 through \$15,000; 4.3 percent of all wages over \$15,000.

Basic Plan members make no contributions. For a limited period ending December 31, 1992, an active Basic Plan member could enroll in the MIP by paying the contributions that would have been made had enrollment occurred initially on January 1, 1987 or on the date of hire, plus interest. MIP contributions at the rate of 3.9 percent of gross wages begin at enrollment. Market rate interest is posted to member accounts on July 1st on all MIP monies on deposit for 12 months. If a member leaves MPSERS service and no pension is payable, the member's accumulated contribution plus interest, if any, are refundable.

Free Soil Community School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE H—EMPLOYEE BENEFITS—Continued

Employee Retirement System – Defined Benefit Plan—Continued

Funding policy—Continued

The School District is required to contribute the full actuarial funding contribution amount to fund pension benefits, plus an additional amount to fund retiree health care benefit amounts on a cash disbursement basis. The rate for the year ended June 30, 2006, was 16.34 percent of payroll. The contribution requirements of plan members and the School District are established and may be amended by the MPSERS Board of Trustees. The School District contributions to MPSERS for the year ended June 30, 2006, 2005 and 2004 were approximately \$117,000, \$127,000 and \$107,000, respectively, and were equal to the required contribution for those years.

The School District is not responsible for the payment of retirement benefits which is the responsibility of the State of Michigan.

Other post-employment benefits – Under the MPSERS Act, all retirees have the option of continuing health, dental and vision coverage.

NOTE I—COMMITMENTS AND CONTINGENCIES

Commitments

- **Federal Programs** – The School District participates in federally-assisted grant programs, which are subject to program compliance audits by the grantor or its representatives. Such audits of these programs may be performed at some future date. The amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time although the School District expects such amounts, if any, to be immaterial.

Contingencies

- **Construction Contracts** – In August 2006, the School District awarded construction contracts totaling approximately \$49,000. The contracts are the obligations of the Sinking Fund and the School District.

NOTE J—OTHER INFORMATION

Economic Dependence – Prior years revision of the State of Michigan (State) school aid formula for local public schools significantly increased State school aid, and the change in property tax laws significantly decreased local property tax revenues. As a result, State school aid represents approximately 68 percent of General Fund revenues.

Free Soil Community School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED

June 30, 2006

NOTE J—OTHER INFORMATION—Continued

Risk Management – The School District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; error and omissions; injuries to employees; and natural disasters. The School District participates in two distinct pools of educational institutions within the State of Michigan for self-insuring property and casualty and workers' disability compensation. The pools are considered public entity risk pools. The School District pays annual premiums under a retrospectively rated policy to the pools for the respective insurance coverage. In the event a pool's total claims and expenses for a policy year exceed the total normal annual premiums for said years, all members of the specific pool's policy year may be subject to special assessment to make up the deficiency. The workers' compensation pool and the property casualty pool maintain reinsurance for claims generally in excess of \$500,000 for each occurrence with the overall maximum coverage varying depending on the specific type coverage of reinsurance.

The School District continues to carry commercial insurance for other risks of loss, including employee health and accident insurance. No settlements have occurred in excess of coverage for June 30, 2006 or any of the prior three years.

NOTE K—SUBSEQUENT EVENT

On August 18, 2006, the School District received the proceeds of a \$130,000 State of Michigan (State) school aid anticipation note payable. The note payable is not subject to redemption prior to its maturity on August 20, 2007 and bears interest at the rate of 3.68 percent per annum. The School District pledged for payment of the note payable, the amount of state school aid to be received plus the full faith, credit, and resources of the School District.

REQUIRED SUPPLEMENTARY INFORMATION

Free Soil Community School District
REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE
General Fund
For the year ended June 30, 2006

	Budgeted amounts			Variance with final budget - positive (negative)
	Original	Final	Actual	
REVENUES				
Local sources	\$ 253,177	\$ 291,820	\$ 305,426	\$ 13,606
State sources	830,479	808,645	816,398	7,753
Federal sources	65,094	81,403	82,337	934
Incoming transfers and other transactions	17,500	122,676	10,000	(112,676)
Total revenues	1,166,250	1,304,544	1,214,161	(90,383)
EXPENDITURES				
Instruction				
Basic programs	669,786	632,577	588,855	43,722
Added needs	184,791	179,022	177,801	1,221
Support services				
Pupil	22,090	19,591	20,126	(535)
General administration	152,514	186,743	181,103	5,640
Business	63,350	39,235	36,736	2,499
Operations and maintenance	157,760	171,546	119,232	52,314
Pupil transportation services	94,169	87,281	90,992	(3,711)
Central	5,245	19,597	19,045	552
Outgoing transfers and other transactions	50,000	27,603	23,373	4,230
Total expenditures	1,399,705	1,363,195	1,257,263	105,932
Excess (deficiency) of revenues over (under) expenditures	\$ (233,455)	\$ (58,651)	(43,102)	\$ 15,549
Fund balances at July 1, 2005			65,936	
Fund balances at June 30, 2006			\$ 22,834	

OTHER DOCUMENTS

BRICKLEY DeLONG

CERTIFIED PUBLIC ACCOUNTANTS

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT
OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARDS**

November 1, 2006

Board of Education
Free Soil Community School District
Free Soil, Michigan

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Free Soil Community School District as of and for the year ended June 30, 2006 which collectively comprise Free Soil Community School District's basic financial statements and have issued our report thereon dated November 1, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Free Soil Community School District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Free Soil Community School District's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions have been reported to the management of Free Soil Community School District in a separate letter dated November 1 2006.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether Free Soil Community School District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Education, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Brickley DeLong, PLC

BRICKLEY DELONG

CERTIFIED PUBLIC ACCOUNTANTS

November 1, 2006

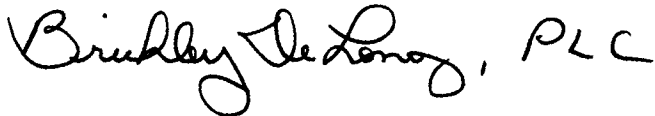
Board of Education
Free Soil Community School District
Free Soil, Michigan

In planning and performing our audit of the financial statements of Free Soil Community School District for the year ended June 30, 2006, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. However, we noted certain matters involving internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect Free Soil Community School District's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. We have attached a summary of such reportable conditions.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, none of the reportable conditions described above is believed to be a material weakness.

This report is intended solely for the information and use of the Board of Education, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Brickley DeLong, PLC". The signature is written in a cursive, flowing style.

REPORTABLE CONDITIONS

Payroll

Recommendation 1: The duties and responsibilities within the payroll function should be further segregated.

During our review of procedures and internal controls surrounding the payroll function, we noted that the bookkeeper is responsible for personnel file maintenance, original input, and payroll changes to the payroll master file; entering data for payroll computation; reviewing payroll output; and distributing W-2 forms. The maintenance of these payroll functions by one individual significantly increases the possibility that errors or misappropriations of funds would not be detected.

We realize the size of the business office provides for limited segregation of duties; however, additional review procedures by appropriate individuals would strengthen internal controls. The supervisor of the business manager should review payroll registers for reasonableness and account distribution, and should distribute the W-2 forms. This additional review would reduce the possibility of inaccurate or unauthorized payroll disbursements.

Recommendation 2: Documentation of approved pay rates for non-union personnel should be improved.

During our audit, we noted in the Board of Education minutes that the Board approved various wage rates, but there is no documentation in the minutes or employee personnel files of those approved rates.

A listing of the approved wage rates signed by a member of the Board of Education or the Superintendent should be maintained by the business office or put in the employee personnel files.

Interim Obligations

Recommendation 3: The various due from/due to other fund account balances should be reconciled on a monthly basis.

During our audit, we noted that due from/due to other fund account balances were not reconciled on a regular basis during the year ended June 30, 2006. This causes such accounts to not be properly reported on monthly financial statements and required School District personnel to prepare a significant number of adjusting journal entries at year end.

The reconciliation of due from/due to other fund accounts on a monthly basis would increase the accuracy of monthly financial statement and reduce the reconciliation and adjustment process presently being required at year end.

REPORTABLE CONDITIONS—CONTINUED

Cash

Recommendation 4: Long outstanding bank account checks should be investigated and, if appropriate, be written off.

During our detailed tests of year end bank reconciliations, we noted that certain checks have been outstanding and maintained on bank reconciliations for periods in excess of a year. The payees should be contacted to determine if additional checks should be issued or City personnel should make a determination as to whether such long outstanding checks should be simply written off.

The investigation of checks outstanding in excess of one year and the possible reissuance of new checks or writing off of such old checks would reduce the time required to prepare bank reconciliations and may identify matters which require further review.

Accounts Payable

Recommendation 5: Complete voucher packages should be prepared and approved before payment.

During our detailed tests of cash disbursements, we noted numerous voucher packages which did not include evidence of receipt, vendor invoices, and proper approval.

The preparation of voucher packages complete with all pertinent information and approvals would provide essential evidential matter for those authorizing cash disbursements.

Other

Recommendation 6: Journal entries and bank reconciliations should be reviewed monthly by appropriate personnel.

During our audit, we noted the journal entries and bank reconciliations for the fiscal year were reviewed in June 2006.

The timely review of journal entries and bank reconciliations would increase the reliability of interim financial statements and inaccurate and/or inappropriate journal entries or bank reconciling items would be identified much sooner.

REPORTABLE CONDITIONS—CONTINUED

Recommendation 7: The School District should comply with the State School Aid Act (Act 94) of 1979.

The State School Aid Act (Act 94) of 1979 prohibits deficit (negative equity) budgeting. During our audit, we noted that the School District adopted a deficit budget. According to the State School Aid Act:

...A district receiving money under this act shall not adopt or operate under a deficit budget and a district shall not incur an operating deficit in a fund during a school fiscal year (MCL 388.1702)...

...A district having an existing deficit or which incurs a deficit shall not be allotted or paid a further sum under this act until the district submits to the department for approval a budget for the current school fiscal year and a plan to eliminate the district's deficit not later than the end of the second school fiscal year after the deficit was incurred (MCL 388.1702).